JAMES H. MCKE

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1907.

Guarantee Company of North America

vs.

Mechanics' Savings Bank & Trust Co.,

For the use of J. J. PRYOR, Assignee.

PETITION OF THE GUARANTEE COMPANY OF NORTH AMERICA FOR WRIT OF CERTIORARI

Requiring the Circuit Court of Appeals for the Sixth Circuit to Certify the Case to the Supreme Court, for its Review and Determination.

GRANBERY & MARKS,
OF COUNSEL.

IN THE

SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM, 1897.

Guarantee Company of North America

v.

Mechanics' Savings Bank & Trust Co.,

For the use of J. J. PRYOR, Assignee.

PETITION FOR WRIT OF CERTIORARI

REQUIRING THE CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT, TO CERTIFY TO THE SUPREME COURT, FOR ITS REVIEW AND DETERMINATION, THE CASE OF THE GUARANTEE COMPANY OF NORTH AMERICA, APPELLANT, v. THE MECHANICS' SAVINGS BANK & TRUST COMPANY, FOR THE USE OF J. J. PRYOR, ASSIGNEE, APPELLEE.

To the Honorable the Supreme Court of the United States:

Your petitioner, the Guarantee Company of North America, respectfully shows to this Honorable Court, as follows:

Your petitioner is, and has been since 1872, a corporation chartered and organized under the laws of the Dominion of Canada, engaged, under authority of its charter, in the business of guaranteeing the fidelity of persons in positions of trust. The Mechanics' Savings Bank & Trust Company was, in the year 1888 and prior thereto, a corporation, chartered and organized under the general laws of the State of Tennessee, engaged, under the authority of its charter, in the business of

a bank of deposit and discount and in accepting and executing various trusts, having a capital of $50,000.

Among its other officials and employes, required in the conduct of its corporate business, was one John Schardt, who was its teller and collector from January 16, 1888, to January 1, 1893, and its cashier from January 1, 1893, to April 17, 1893. On January 16, 1888, in consideration of the payment of a premium of $100, petitioner entered into a contract with the Mechanics' Savings Bank & Trust Company, being bond No. 93,525, in the penalty of $10,000, agreeing to make good and reimburse to it such pecuniary loss as it should sustain by the fraudulent acts of John Schardt in connection with the duties of his office of teller and collector for a term of one year thereafter. In the bond evidencing the contract, it was stipulated, among other things:

"The following provisions are also to be observed and bind-
"ing as a part of this bond:

. . . . . .

"That the employer (meaning said Mechanics' Savings Bank
"& Trust Company) shall observe or cause to be observed all
"due and customary supervision over the said employe (mean-
"ing said Schardt), for the prevention of default. . . .

"That the employer (meaning said Mechanics' Savings Bank
"& Trust Company) shall at once notify the company on his
"becoming aware of the said employe (meaning said Schardt)
"being engaged in speculation or gambling or indulging in any
"disreputable or unlawful habits or pursuits.

"That there shall be an inspection or audit of the accounts
"or books of the employe on behalf of the employer at least
"once in every twelve months from the date of this bond."

The bond so entered into was renewed from year to year, until January 1, 1893, but at no time until the Mechanics' Savings Bank and Trust Company had certified that the accounts of said Schardt, for the year just ended, had been examined and verified.

The said employer ceased to observe, or cause to be observed, due and customary supervision over the said Schardt for the prevention of default, and, on September 12, 1890, he began to default, by embezzling the funds of his employer. He continued his default, and embezzled by constant and continued abstractions amounts as follows: From September 12, 1890, to January 16, 1891, $5,879.34; from January 16, 1891, to January 1, 1892, $22,290; from January 1, 1892, to January 1, 1893, $50,649.90. The amounts so embezzled he lost in speculations on stocks, grain, cotton, and other commodities.

In the summer or fall of 1892, one Kyle, of New York, representing Myers & Co., of that city, came to Nashville, and proposed to Charles Sykes, then cashier of the Mechanics' Savings Bank & Trust Company, to become interested in the "brokerage" business, and to represent Myers & Co. at Nashville. Cashier Sykes replied that he did not like the idea, because it would be a purely speculative business. Mr. Kyle then said that that made no difference, that the teller of the bank, John Schardt, was a part owner in a similar concern. Cashier Sykes at once told Lewis T. Baxter, the president of the Mechanics' Savings Bank & Trust Company, of the conversation. The next day he told John Schardt of what Mr. Kyle had said. Said Schardt then admitted to said Sykes that he had at one time been interested in such a concern, but said he had sold his interest. In this same conversation he admitted to Cashier Sykes that he had speculated to some extent, but had made money on every transaction, and had seen the error of his way and ceased to do so any more. Cashier Sykes immediately told President Baxter of what said Schardt had said.

Some time thereafter Cashier Sykes received an anonymous letter telling him that Schardt had been speculating. He showed it to President Baxter, but he said not to pay any attention to it. Cashier Sykes spoke to said Schardt about it. Said Schardt said that he thought he knew the author, and asked that he be given the letter, and said that he would bring the party before Mr. Sykes, and make him acknowledge that it was false. Mr. Sykes gave him the letter, and asked him about it several

times. Said Schardt always replied that he was working on the matter. Mr. Sykes told President Baxter of these conversations.

At some time before January 1, 1893, Mr. J. M. Eatherly, a stockholder, director, and a member of the finance committee of the Mechanics' Savings Bank & Trust Company, saw a letter to the effect that Schardt was a partner in a "bucket shop," directed to Judge John Woodard, another director. When Judge Woodard showed it to him, said Eatherly asked permission to call Mr. Schardt up and show it to him, which was granted. He at once called Schardt to him, and said that there was a communication that he wanted him to read. Said Schardt read the letter, and remarked: "It's a lie, and I can prove it." Mr. Eatherly told Mr. Schardt that it devolved on him to prove it false. Mr. Schardt immediately went out, and returned with one Frank Searight and a Dr. Barry. President Baxter, Judge Woodard, and Mr. Eatherly went to the rear of the bank building with Schardt and Messrs. Searight and Barry. In this conference Mr. Searight said that at some time before, Mr. Schardt, Dr. Barry and himself had agreed to open a "brokerage association," each contributing $200 to its capital. For some reason Mr. Schardt became dissatisfied in a short time, and sold his interest to Mr. Searight.

Subsequent to that conversation, and before January 1, 1893, Mr. Eatherly heard again that Schardt was speculating. He went to Schardt's house to see him about it, and told him what he had heard. Schardt said that it was not so, that he did not own any stocks at all, having sold everything he had. Mr. Eatherly told him that if he was speculating, he ought to quit that or quit the bank.

Petitioner had caused to be inserted in the bond of suretyship issued the condition referred to, providing that the employer should at once notify petitioner on its becoming aware of the said employe being engaged in speculation or gambling, for the reason that petitioner declines to become, or remain, the surety of any person in a fiduciary position who speculates, since petitioner has found, by long experience, that such a person

cannot be safely trusted. Had the Mechanics' Savings Bank & Trust Company notified petitioner of the facts so made known to it through its president, its cashier, and two of its directors, and a member of its finance committee, petitioner would have at once retired from said bond and canceled the same. When such information did in fact come to petitioner through other sources, in April, 1893, petitioner immediately canceled another bond it had issued to the Mechanics' Savings Bank & Trust Company, guaranteeing the fidelity of said John Schardt in the position of cashier.

But the Mechanics' Savings Bank & Trust Company wholly failed to comply with its undertaking in said bond, and did not notify petitioner of its becoming aware of said Schardt being engaged in speculation, as hereinbefore set out. On becoming aware thereof, it did not dismiss said Schardt from its employ, nor did it cause his accounts to be examined. Such examination would have immediately disclosed his large embezzlements, lost in the speculations he admitted himself to have been engaged in. On the contrary, it retained him in its employ, and, on January 1, 1893, promoted him by election to be its cashier.

Thereupon, the Mechanics' Savings Bank & Trust Company made application to petitioner to become the surety of said John Schardt, in the sum of $20,000, in his new position of cashier. For the purpose of determining whether or not it would become such surety, and before it would consent thereto, petitioner required Lewis T. Baxter, president of said Mechanics' Savings Bank & Trust Company, to make in its application for such bond, written answers to certain material questions. Among other such questions regarding said Schardt, and answers thereto, were the following:

"Have you ever known or heard anything unfavorable as to "his habits, past or present?

"No.

"Or of any matters concerning him about which you deem it "advisable for the company to make inquiry?

"No."

In making such answers, instead of disclosing the facts regarding the speculations by said Schardt, of which he had not only heard, but of which he knew by said Schardt's admissions, he concealed the same, and made false and untrue answers to the questions. By the terms of the subsequent contract, the Mechanics' Savings Bank & Trust Company agreed that any misstatement of a material fact in said application would render the bond void from the beginning.

But, misled by the false answers to the said questions, and deceived by the suppression of the facts known to said Mechanics' Savings Bank & Trust Company, and its president, Lewis T. Baxter, on January 1, 1893, petitioner issued and delivered to the Mechanics' Savings Bank & Trust Company, its bond, number 154,806, in the penalty of $20,000, whereby petitioner covenanted to reimburse to the Mechanics' Savings Bank & Trust Company, its representatives or assigns, the amount of any loss not exceeding $20,000, which should be sustained by it during the year 1893 by reason of any act of fraud committed by said Schardt, in connection with the duties of cashier, and constituting embezzlement or larceny.

After the issuance and delivery of said bond, the Mechanics' Savings Bank & Trust Company failing to exercise due and customary supervision over said Schardt for the prevention of default, said Schardt continued his embezzlements, and between the date the bond came into force and April 15, 1893, he embezzled the further sum of $22,964.17.

On April 15, 1893, after petitioner had learned of the speculations on the part of said Schardt, and, in consequence, had canceled the said bond, notifying the said Mechanics' Savings Bank & Trust Company that such cancellation was on account of learning of such speculations, said Mechanics' Savings Bank & Trust Company caused the books and accounts of said Schardt to be examined. Such examination, continued during a part of that day, disclosed a shortage of more than $50,000, to which said Schardt confessed. Knowing the whole of the capital stock of the bank, and possibly a greater sum, to have been lost by the default of said Schardt, the board of di-

rectors of the Mechanics' Savings Bank & Trust Company, on April 17, 1893, the first business day after such discovery, caused to be executed a general assignment to James J. Pryor, conveying to him all its assets, for the equal benefit of all its creditors.

On April 19, 1894, James J. Pryor, a citizen of the State of Tennessee, as such assignee, filed his bill in the chancery court of Davidson county, Tennessee, in the name of the Mechanics' Savings Bank & Trust Company, for his use, against petitioner and the Union Bank & Trust Company, a corporation of the State of Tennessee, as administrator of John Schardt, who had died on April 17, 1893, alleging, among other things, the holding by the said Schardt of the offices of teller and cashier, the issuance and delivery of the said two bonds of suretyship by petitioner, and the renewals of the first thereof, and the defaults above set out on the part of said Schardt, and praying for the taking of an account of such defaults and recoveries on said bonds for the full amounts thereof.

On June 11, 1894, and before the time petitioner was required to make defense to the bill under the laws of Tennessee, petitioner filed its petition in said cause in said chancery court of Davidson county, Tennessee, praying its removal into the United States circuit court for the middle district of Tennessee, on the ground that petitioner, one of the defendants therein, was not a citizen of the State of Tennessee, but was a citizen of the Dominion of Canada, alleging that there existed in said suit a controversy between complainant and petitioner, which could be fully determined as between them, accompanying such petition with the bond required by law. On the filing of said petition and bond, said chancery court of Davidson county, Tennessee, entered a decree, ordering that the case should be no further proceeded with in that court, and directing its clerk and master to forthwith certify to the circuit court of the United States for the middle district of Tennessee, a full and complete copy of the proceedings in the cause, which was done, and such copy was filed with the clerk of said court, on July 11, 1894.

On the same day, to wit, on July 11, 1894, petitioner filed

its answer in said cause, setting up, among other things, the breaches on the part of the Mechanics' Savings Bank & Trust Company, of the conditions of the first bond on John Schardt, as teller and collector, whereby said Mechanics' Savings Bank & Trust Company agreed to observe, or to cause to be observed, all due and customary supervision over said employe for the prevention of default, and to inspect or audit his accounts and books at least once a year, and to at once notify petitioner on its becoming aware of the said employe being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits, setting up that the certificates made yearly that the accounts of said employe had been examined and verified and found correct, on faith of which the yearly renewals were granted, were false and untrue; and setting up that the second bond, that on John Schardt as cashier, was issued on the faith of the representations of Lewis T. Baxter, president of the Mechanics' Savings Bank & Trust Company, that he had neither known nor heard of anything unfavorable as to said Schardt's habits and associations, and that he neither knew nor had heard of any matters concerning which he deemed it advisable for petitioner to make inquiry, when in fact said Baxter knew of said Schardt's having been engaged in speculations, and being a partner in a firm organized to carry on a purely speculative business. These matters and things, among others, petitioner set up to defeat a recovery on said two bonds.

The said cause was and is entitled in the circuit court of the United States for the middle district of Tennessee, "The Me-"chanics' Savings Bank & Trust Company, to the use of J. J. "Pryor, assignee, etc., *v.* The Guarantee Company of North "America."

The case was heard and determined by the said circuit court, upon the following testimony of Charles Sykes, J. M. Eatherly, and Theo Cooley, being all the evidence in the case touching the speculations of the said John Schardt:

TESTIMONY OF CHARLES SYKES.

"*Ques.* 5. Were you cashier of the bank during the whole "of the year 1892?

"*Ans.* Yes, sir.

"*Ques.* 6. Did you, at any time during that year, receive in- "formation that John Schardt was speculating? If so, state "when, how, and all the circumstances.

"*Ans.* Yes, sir; I did receive such information. Some time "in the summer or fall of 1892, a gentleman by the name of "Kyle came here from New York, representing Myers & Co., "of New York. Kyle wanted me to become interested in the "brokerage business, and represent Myers & Company at this "point. I told him that I did not like the idea, because it would "be purely a speculative business, and he then said that that "made no difference, that John Schardt, our teller, was a part- "ner in a similar concern.

"*Ques.* 7. Did you impart this knowledge to anyone? If so, "whom?

"*Ans.* Yes, sir; I at once told Mr. L. T. Baxter, the presi- "dent of the bank, of the conversation.

"*Ques.* 8. Did you say anything to Schardt about the mat- ter?

"*Ans.* Yes, sir; on the next day, I think, I told Mr. Schardt "of what Kyle had said.

"*Ques.* 9. What did Schardt say to you in reply?

"*Ans.* He admitted that he had, at one time, been interested "in such a concern, but had sold his interest; and that he had "speculated to some extent, but had made money on every "transaction, and had seen the error of his way, and had ceased "to do so any more.

"*Ques.* 10. Did you impart this information received from "Schardt to anyone connected with the bank? If so, whom?

"*Ans.* Yes, sir; I immediately told Mr. Baxter, the presi- "dent of the bank, what Schardt had said.

"*Ques.* 11. Did you receive any other information, at any "other time, with reference to Schardt's speculating?

"*Ans.* Yes, sir; some time thereafter I received an anony-
"mous letter, telling me that Schardt had been speculating.

"*Ques.* 12. What did you do with it, and what became of it?

"*Ans.* I showed it to Mr. L. T. Baxter, the president, and
"he said not to pay any attention to an anonymous letter; and
"I spoke to Schardt about it, and he said he thought he knew
"the author, and asked me to let him have the letter, and he
"would bring the party before me, and make him acknowledge
"it was false.

"*Ques.* 13. Did you give him the letter, and did he bring
"the party before you?

"*Ans.* I gave him the letter, and asked him about it more
"than once, and he always replied that he was working on it.

"*Ques.* 14. Did you tell Mr. Baxter of this conversation?

"*Ans.* I think I did."

TESTIMONY OF J. M. EATHERLY.

"*Ques.* 98. Did you ever hear of Schardt's speculation be-
"fore January, 1893?

"*Ans.* I think I did.

"*Ques.* 99. Did you see the anonymous letter written with
"respect to his speculating?

"*Ans.* I saw a letter directed to Judge John Woodard.
"Judge Woodard brought that letter to the bank and showed it to
"me, and I asked permission to call Mr. Schardt up and show
"it to him, and he said he was perfectly willing that I should do
"so. I at once called Mr. Schardt to where we were, and told
"him there was a communication I wanted him to read. He
"did so, and his remarks were: 'It is a lie, and I can prove it.'
"In this letter it was stated that Mr. Schardt was a partner in
"a bucket shop. I told Mr. Schardt that it devolved on him
"to prove it false. I at once reported the contents of this
"letter to the president of the bank, Mr. Baxter. Mr.
"Schardt asked that I and Judge Woodard remain there for a
"few minutes. He went out and got Frank Scaright and Dr.
"Barry. Judge Woodard, Mr. Baxter, and myself went into

"the rear of the bank building. Mr. Schardt and the other "gentlemen came back, and Mr. Schardt says: 'Here are the "men who can tell you whether that is so or not.' I asked "them if they knew why we had sent for them, and they said "Mr. Schardt had told them. Mr. Searight said that, some "time before, Mr. Schardt, Dr. Barry, and himself had agreed "to open a brokerage association. They objected very much "to the term 'bucket shop.' Each one was to put in a small "amount—$200, I think. Mr. Schardt, in a short time, be- "came dissatisfied, and sold his interest to Frank Searight at "a small loss. Subsequent to that, I went to Mr. Schardt's "house to see him, having heard again that he was speculating. "I told him what I had heard, and he said that it was not so; "that he did not own any stocks at all. I told him if he was "he ought to quit that or quit the bank, and he said he had "sold everything he had. I again heard that he was specu- "lating, but from sources that I did not attach any importance "to, as it all emanated from the same source as the anonymous "letter. I again approached him, and he denied it.

"*Ques.* 100. Was this just prior to the resignation of Judge "Woodard as a member of the board?

"*Ans.* I think it was.

"*Ques.* 101. Do you know when he resigned?

"*Ans.* His resignation bears date February 17, 1893; was "placed before the board of directors and accepted March 25, "1893.

"*Ques.* 102. Did Mr. Baxter, the president, ever say any- "thing to you about Schardt's speculating?

"*Ans.* I don't think he ever did."

TESTIMONY OF THEO. COOLEY.

"*Ques.* 3. Did the defendant company at any time cancel its "bond on John Schardt while he was cashier of the complainant "company? If so, when, and for what reason?

"*Ans.* Yes, sir; the company did cancel its bond through "me, as its agent, the Saturday before the bank assigned on

"Monday. The cause which led to this action was that I had "ascertained that John Schardt had been speculating in futures, "and I so reported to the bank when the bond was canceled.

"*Ques.* 9. Did you know or hear of Schardt's speculations "prior to the time mentioned above when you received such "information?

"*Ans.* I did not.

"*Ques.* 10. Have all matters pertaining to the issuance of "the bonds upon Schardt in favor of the complainant passed "through your hands as representative of the company?

"*Ans.* They have, so far as I know.

"*Ques.* 11. Is it or not a part of your duties to gather in- "formation concerning applicants for bonds, and about persons "already bonded in the defendant company, in this part of the "country?

"*Ans.* Yes, sir.

"*Ques.* 12. Do you transmit such information to the home "office of the company?

"*Ans.* I do.

"*Ques.* 13. If the company had received any information "with respect to Schardt's speculations, or other information "unfavorable to him, would you have been advised of the fact "by the company?

"*Ans.* I would, as that is the usual method of doing busi- "ness."

Such proceedings were had in said case in said circuit court of the United States that, on July 1, 1895, the said court rendered a decree therein as follows:

"This cause was heard at a previous day of the term, and "the court took an advisement to this day, the cause having "been heard upon the original bill, answer, stipulations, and "proof, as well as upon an argument of counsel. One of the "stipulations is as follows:

"'It is stipulated and agreed in this case that should any "court hold that this case, on its removal to the federal court "from the state court, should be put upon the law docket, a

"jury is expressly waived, and the same shall be heard and "decided by the court without the intervention of a jury, and "upon its merits, without regard to the form of the pleadings, "and that the issues made in the pleadings as they stand, shall "constitute the issues to be tried by the court; also, that all "captions and certificates to depositions are waived, as well as "the fact that some of the depositions are not subscribed or "sworn to.'

"The court is of opinion, and adjudges and decrees, as follows:

"That Schardt has been a defaulter within the sense of his "two bonds; that in the years 1890 and 1891, the amount of "his embezzlement from the bank was comparatively small, "and has been paid out of assets and collections theretofore "transferred to the bank by Schardt, to secure it, just before "his death; that the embezzlements for the year, commencing "September 1, 1890, to January 16, 1891, amounted, in the "aggregate, to $5,879.34—with interest to April 15, 1893, of "$890.04, makes $6,769.38. From January 16, 1891, to "January 1, 1892, $22,290; interest to April 15, 1893, of "$2,299.08 added, makes $24,589.08. From January 1, 1892, "to January 1, 1893, $50,649.90; with interest to April 15, "1893, of $2,086.27 added, makes $52,736.17, and these from "January 1, 1893, to April 17, 1893, during the currency of "his said bond as cashier to $22,964.17, which, with interest "to April 15, 1893, of $164.52, makes the sum of $23,128.69 "in the aggregate; and that the total amount of said embez-"zlements during all the years mentioned, in both positions, "was, of principal, $101,783.41, which, with interest to April "15, 1893, of $5,439.91 added, makes an aggregate of "$107,223.36.

"It appearing that Schardt had assigned to the bank, to in-"demnify it against loss, two lots of land assigned to J. B. "Richardson, and life insurance policies amounting to $80,000, "some of which policies have been paid to the assignee without "suit, and others are now in litigation in this court, or pend-"ing on appeal or writ of error to the appellate court of this "circuit, held at Cincinnati, the court adjudges upon inspection

"of said guaranty bonds, their terms and various conditions "and the proof submitted, that the bank has complied with the "same, and all its undertakings thereunder substantially, and "that said Schardt embezzled and fraudulently appropriated "the moneys of the bank, while he filled said two positions, to "the amounts named, and that interest should be calculated "upon said sums from the end of his respective terms.

"The court, after considering the numerous and various de- "fenses set up by defendant company why a recovery should "not be had upon either of said bonds, or both, in favor of "complainant, is pleased to disallow each and all of said de- "fenses, and to order, adjudge, and decree that complainant have "its decree or judgment against the defendant, the guarantee "company, upon each of said bonds, with interest from the time "the same should have been paid according to the terms of said "bonds, and for the costs. That complainant have judgment "on the teller's and collector's bond for the sum of $10,000 "principal, and the further sum of $770, being interest at six "per cent. from April 9, 1894, to July 1, 1895, and that com- "plainant have judgment on the cashier's bond against defendant "guarantee company for the sum of $20,000 principal, and the "further sum of $1,540, interest thereon from April 9, 1894, to "July 1, 1895, making, in the aggregate of principal and in- "terest on both bonds, the sum of thirty-two thousand three "hundred ten ($32,310) dollars, with interest thereon until "paid, and the costs of this suit.

"And the court orders and decrees that the liability of the de- "fendant, the guarantee company, is secondary to that of John "Schardt's estate, and that the bank or its assignee shall account "for all collections realized on assets or collaterals turned over "to the bank by said Schardt to reimburse it against his short- "age, which it has collected, or with due diligence may collect "hereafter; and for his fitness, and for convenience, H. M. Doak "is appointed master commissioner to report the same to the "next term of this court; and the court orders that the same "be applied to the shortage of said Schardt, in the order in "which the same occurred, and in the meantime no execution

"will issue against the defendants for the same, but only for the "costs; and the court orders that this cause may be continued "upon the docket of this court for the purpose only of making "any orders necessary to apply all collections from assets of "Schardt held as collateral in exoneration to that extent of the "defendant company, and of substituting the defendant to the "rights of the bank in case the recovery herein is collected or "paid and any of said assets remain above the amount neces- "sary to satisfy the shortage. But the case is retained for no "other purpose, and the decree against defendant company is "final as fixing its liability on the bonds to make good the short- "age, whatever that may be. This decree is entered in lieu of "one entered at a former day of the term, and the decree "formerly entered is hereby vacated."

The said case in the said circuit court of the United States was heard before and decided by the Hon. C. D. Clark, district judge for the middle and eastern districts of Tennessee, sitting in said court, and the opinion of the court was delivered by him.

Your petitioner, on August 18, 1895, was duly allowed by said circuit court an appeal from its said decree to the United States circuit court of appeals for the sixth circuit, and it was ordered by the court that a certified transcript of the record and of all proceedings in said case be forthwith transmitted to said United States circuit court of appeals.

On August 28, 1895, a certified transcript of the record and of all proceedings of the said circuit court in said case was filed in the United States circuit court of appeals for the sixth circuit, and the said case was entered and docketed in the said court of appeals and entitled "*The Guarantee Company of "North America, appellant*, v. *The Mechanics' Savings Bank & "Trust Company, for the use of J. J. Pryor, assignee, etc., ap- "pellee.* No. 349."

The assignment of errors filed on behalf of your petitioner, was as follows:

"Now, to wit, on the first day of August, in the year of our

"Lord 1895, at the April term of the circuit court of the "United States for the middle district of Tennessee, in the city "of Nashville, State of Tennessee, comes the said Guarantee "Company of North America, by Granbery & Marks, its solic- "itors, and says that, in the record and proceedings in the "above styled matter, there is manifest error in this, to wit:

"I.

"In Re Cashier's Bond.

"1. The court erred in not sustaining the defense of a fraud- "ulent and material misrepresentation by which the said bond "was procured, such misrepresentation being that the books "and accounts of said employe had been examined and found "correct, December, 1892.

"2. The court erred in not sustaining the further defense of "a fraudulent and material misrepresentation as to there hav- "ing been no default by a former cashier in the bank.

"3. The court erred in not sustaining the defense of a sup- "pression of material matters affecting the risk, to wit, the fact "that said employe had been known to have engaged in spec- "ulation, and to have owned an interest in a brokerage concern, "while the teller of said bank.

"4. The court erred in holding defendant liable for $5,- "992.35 of overdrafts by customers of the bank, because the "defendant only contracted to pay losses occasioned by the "fraudulent acts of said employe, and constituting larceny or "embezzlement.

"5. The court erred in holding that said bond was ever in "force or ever took effect.

"6. The court erred in not sustaining the defense of the "bank permitting the employe to occupy a dual position while "he was bonded in one position, and thereby materially en- "abling such employe to abstract the funds of the bank and "conceal the same, and subjecting him to greater temptations "to abstract the funds of the bank.

"7. The court erred in not sustaining the above defenses "and in not dismissing the bill.

"II.

"In Re Teller's Bond.

"1. The court erred in not sustaining the defense of a material "and fraudulent misrepresentation made by the complainant "bank to procure a renewal of said bond in January, 1892; said "misrepresentation being that the books and accounts of the "employe, Schardt, had been examined in December, 1891, "and verified.

"2. The court erred in not sustaining the defense of a failure "on the part of the bank to notify the defendant of specula- "tion by said employe during the currency of the bond.

"3. The court erred in not sustaining the defense of the "failure of the bank to cause to be observed all due and cus- "tomary supervision of said employe to prevent a default "during the currency of the bond.

"4. The court erred in not sustaining the defense of the "failure of the bank to make a proper inspection or audit of "the books and accounts of said employe once each year during "the currency of the bond.

"5. The court erred in not sustaining the defense that the "bond provide for the payment of such losses only as are "discovered during the currency of the bond, where the em- "ploye does not sooner leave the service.

"6. The court erred in not sustaining the defense of the "bank permitting the employe to occupy a dual position while "he was bonded in one position, and thereby materially en- "abling such employe to abstract the funds of the bank and "conceal the same, and in subjecting him to much greater "temptation to abstract the funds of the bank.

"7. The court erred in not dismissing the bill as to said bond.

"8. The court erred in holding that interest should be com- "puted upon each default prior to the time the same was dis- "covered, notice given, and proper steps taken under the bonds "to mature a liability against the defendant.

"Wherefore, the said Guarantee Company of North America "prays that an appeal may be allowed it from said decree hold-

"ing it liable on said bonds, to the end that said decree may be "corrected and speedy justice done it.

"GRANBERY & MARKS,
"*Solicitors for Defendant.*"

The cause came on to be heard in said circuit court of appeals on December 11 and 12, 1895, before the Hon. William H. Taft and the Hon. Horace H. Lurton, United States circuit judges for the sixth circuit, and the Hon. Eli S. Hammond, United States district judge for the western district of Tennessee; and, on October 5, 1896, the said court rendered a decree affirming the said decree of said circuit court therein, as follows:

"GUARANTEE COMPANY OF NORTH AMERICA
v.
"J. J. PRYOR, *Assignee of Mechanics' Savings Bank & Trust Company.*

In U. S. Circuit Court of Appeals for Sixth Circuit.

"Appeal from the Circuit Court of the United States for the Middle District of Tennessee.

"This cause came on to be heard on the transcript of the "record from the circuit court of the United States for the "middle district of Tennessee, and was argued by counsel. On "consideration whereof, it is now here ordered, adjudged, and "decreed by this court that the decree of the said circuit court in "this cause be, and the same is hereby, affirmed with costs."

Afterwards, and on October 28, 1896, in the said case in the said circuit court of appeals, on motion of petitioner's counsel, an order was entered, extending the time for petitioner to file a petition for rehearing for thirty days from the day upon which the printed copy of the opinion of the court in the case should be deposited in the clerk's office.

On April 29, 1897, such printed copy of the opinion of the court in the case was deposited in the clerk's office.

Afterwards, and on May 27, 1897, petitioner filed its petition in said case in said circuit court of appeals, praying to have said cause reheard, and if such rehearing should be de-

nied, asking the said circuit court of appeals to certify to this honorable court the important questions of law involved, for its determination, as provided by the sixth section of an act of Congress, entitled "An act to establish circuit courts of appeal, "and to define and regulate in certain cases the jurisdiction of "the courts of the United States, and for other purposes," approved March 3, 1891.

Afterwards, and on July 6, 1897, the said circuit court of appeals, being composed of the same judges who had theretofore tried and determined the case, denied the petition for a rehearing in the following decree:

"GUARANTEE COMPANY OF NORTH AMERICA
v.
"J. J. PRYOR, *Assignee of Mechanics' Savings Bank & Trust Company.*
In U. S. Circuit Court of Appeals for Sixth Circuit.

"Petition for rehearing filed herein, is hereby denied."

A certified copy of the entire record of the said case in said circuit court of appeals is herewith furnished and hereto annexed as part of this application, in conformity with rule 37 of this honorable court, relative to cases from circuit courts of appeals, and the same is marked exhibit A.

Your petitioner is advised that the said decree of the said circuit court of appeals in the said case is erroneous, and that this honorable court should require said case to be certified to it, for its review and determination under and in conformity with the provisions of the sixth section of the act of Congress, entitled "An act to establish circuit courts of "appeal, and to define and regulate, in certain cases, the jurisdiction of the courts of the United States, and for other purposes," approved March 3, 1891, the decree in said case being made final in the said circuit court of appeals by the said act.

Petitioner shows to the court that the business of guaranteeing the fidelity of persons in positions of trust is of recent origin. It is the last phase of the insurance business to be developed to widespread extent. The business has, in the last few years, expanded very rapidly. At first confined to guaranteeing

the fidelity of employes of railroad companies and banks, it has now extended to the making of bonds for every class of persons in positions of trust, in whatsoever manner named or appointed. Many of the largest employers of such persons now require such a bond as a condition of employment. Within the United States there are now fifteen companies, with a capital of $7,804,600, engaged in the business. Their total premium receipts for the year 1896 were $3,138,848. The total number of bonds issued was about 450,000, and the total amount at risk thereunder was $671,548,077. New companies are constantly organizing, and the business of making such bonds is steadily growing. So far as petitioner has been able to find, this is the first case arising in the courts of the United States involving not only the disclosures required of persons seeking such bonds of indemnity in making application therefor, and the effect of misrepresentations made in such applications, but also involving the general rules which will govern the courts in considering the conditions and requirements of the bonds issued regarding supervision by the employer over the bonded employe. This suit presents fully the questions concerning the relations of the parties before and after the making of such bonds.

Petitioner shows to the court that it is of the greatest moment and importance, not only to the companies, which have so large an amount at risk, but also to the employers who seek and procure such bonds, that there shall be an authoritative decision of the principles of law which govern the parties, both in the procuring of such bonds and in their relations to each other after their issuance, and while they continue in force. If the holding of the circuit court of appeals in this case that the employer, in seeking such bond, is not bound to make disclosure of such facts as may be known to him affecting the reliability of the employe sought to be bonded, even when asked in regard thereto by the bonding company, and that an answer which can by any possibility be excused as not being in bad faith, shall not be deemed a misrepresentation avoiding the bond, and that, after procuring such a bond, the employer is bound to no duty and to no diligence in regard to

a supervision of the employe, and all stipulations looking toward requiring the disclosure of discrediting facts known to the employer, either at the time of the issuance of the bond or becoming known to him thereafter, or stipulations regarding the supervision of the employe, are to be construed against the company with the utmost strictness and harshness, shall be sustained, and become the law of the land, it will have the effect to increase greatly the hazard and risk of the business to the companies engaged therein, will cause them heavy losses on bonds already in force, and will result in the permanent injury and loss of the public seeking such bonds, by requiring large increases in the premiums paid therefor, to cover the additional hazard and risk so incurred. It is therefore of the gravest importance to such companies and to the persons procuring their policies to have an early determination of the questions involved in this suit by this honorable court, which, by reason of its authority in the United States courts, and by reason of the comity of the courts of the several states, will become the recognized rule of decision in all of the courts of the United States and of the several states.

The said circuit court of appeals, in laying down the principles which should govern the trial of suits on the bonds of suretyship—such as were issued by petitioner in this case—and in announcing the principles which would govern them in deciding the present case, used the following language in its opinion:

"In marine, fire, and life insurance it is not an unreasonable "assumption that the owner knows more intimately than others "can know the conditions which are material to the risk as- "sumed, and it is, therefore, not unreasonable to require him "to disclose those conditions to the insurer, and to hold him "strictly to that duty. But, in an insurance like this, the in- "surer and the insured deal at arm's length with each other, and "upon a plane of equal opportunity for information. Indeed, "the risk does not depend so much on conditions of fact as "upon a mere judgment about human character in the subject "of the insurance—his individuality of moral qualities. About

"this the insurer can inform himself, and the assured is not "presumed to know anything, as in the case of the owner of a "property or a life which has been insured. Hence, it is not "unreasonable to hold the insurer to his risk, in the broadest "sense that is required to indemnify the assured for any loss "by dishonesty which falls fairly within the employment of the "person whose honesty is guaranteed, and to permit no escape "except by lines of retreat or avenues of deliverance clearly de- "fined, well marked, and mutually understood as part of the con- "tract, evidenced by the use of unambiguous language for that "purpose. . . . And we wish further to remark that "the business honesty or fidelity insured by such contracts as "these, is not that kind of enforced honesty which comes of a "want of opportunity to be dishonest, but that which is to be "sturdy enough to operate for safety, spite of opportunity and "temptation. That is the only kind of insurance worth the "premium paid by the assured, or which is a fair consideration "for the risk of loss which he opens under the protection of "the guaranty, and, in the absence of evidence to the contrary, "presumably that which is bargained for in each instance. A "kind of honesty which will not take advantage of lapses of "watchfulness to construct deceitful appearances adjusted to "familiar traits or habits of carelessness on the part of the "employer, perhaps indulged because of reliance upon the "insurance which has been accepted as a protection. An "employer would need no insurance against that close and "relentless vigilance which makes stealing impossible, and "under these contracts he is bound to no watchfulness ex- "cept that which he has contracted to use in plain words "for the benefit of the insurer. The old form of bond "and security was usually without covenants for watchful- "ness or inspection by the employer or other obligee, and as "that is the highest measure of liability of which the busi- "ness is capable, it is that which the obligee would naturally "seek for his protection, always desiring, presumably, to pro- "vide by some such guaranty even against his own negligence "and careless business habits. The nature of the risk for-

"bids the idea of any implied or general limitations upon the "guaranty against loss by dishonesty, and, in our judgment, "these contracts are not to be construed as imposing any by "mere inference of an understanding between the parties that "the business will be conducted with either ordinary or any de-"gree of diligence or prudence as to watchfulness. The in-"surer gets what he contracts for in respect of that, and nothing "more, and he must provide by express stipulation for even "ordinary prudence on the part of the assured in taking meas-"ures for minimizing or lessening the broad risk we have in-"dicated as that most desirable to the assured, and therefore "that which is intended to be covered by the words of insur-"ance in these contracts, except so far as the 'provisos and con-"ditions hereinafter contained' shall have limited that broad "liability. Nothing is to be implied not necessarily indicated "by the words used, as might be in other examples of insur-"ance where the relation of the parties and the character of "the risk are different, and where those relations properly "breed implications that would import a meaning not admis-"sible, when the thing guaranteed is so far disassociated from "any duty owing by the assured to the insurer, as we find in "the subject-matter of insurance here."

Petitioner now shows this honorable court that the circuit court of appeals, in laying down the principle that the rules governing companies carrying on a suretyship business should be stricter and harsher than those applied in cases of contracts of marine, fire, and life insurance, acted on a false and untrue assumption, to wit: that companies engaged in such business could possess themselves of fuller information about the subject of the risk than marine, fire, and life insurance companies could about property or life on which insurance had been solicited. It is true that when an employe has, before his employment, been unknown to the person employing him, his employer seeking a bond and the company of which such bond of suretyship is sought, would have an equal opportunity of securing information concerning him, as to the factors which would

enter into and determine the risk incurred by becoming such surety. But it is untrue that such company would possess means of information equal to those of the employer, where the person on whom the bond is sought has been for years in the service of the employer, as said Schardt had been when the Mechanics' Savings Bank & Trust Company applied for the issuance of a bond on him as cashier.

Your petitioner, and the other companies engaged in a like business, have, by years of experience and observation, been able to determine the causes that ordinarily lead an employe in a position of trust to peculate. They have found that persons in positions of trust who speculate in stocks, grain, cotton, provisions, and like commodities, invariably, lured on by the hope of retrieving past losses, become defaulters to large amounts. They have further found that persons in positions of trust who are in the habit of gaming, will, sooner or later, become losers, and, in consequence, defaulters, though the defaults consequent on such misconduct are not nearly so large as those resulting from speculations involving sums far greater than those at risk on games of hazard. They have found that when an employe has once yielded to temptation and defaulted, he is likely to again default. They have found that persons in positions of trust who live beyond their income, are likewise greatly exposed to the temptation of small peculation, particularly if addicted to immoralities and other excesses. They have further found that the risk is very much increased by the employe who is handling money being harassed by debt. They have found that a man's daily habits and associations determine very largely the likelihood as to whether or not he will continue the faithful discharge of his duties. They have further found that outside of and beyond these personal elements, the character of the supervision over the employe for the prevention of default, and the probability or improbability of an early discovery of any shortage, is a factor of the highest importance in determining whether or not it is likely that an employe will be guilty of his first embezzlement.

On all these points which alone enter into and determine

whether or not a bond of suretyship shall be granted in the first instance, and, after it has been granted, whether or not it shall be continued, the employer in whose service an employe has continued for a long time, is infinitely better able to know than any surety company applied to for a bond. It is to such employer that the company must go for information as to the daily habits and associations of the employe, his former fidelity in the discharge of his duties, his habits of personal extravagance, causing his expenditure to exceed his income, and particularly whether or not he is addicted to gambling or speculation. Such employer alone can know, what is to be the nature of the supervision over the employe for the prevention of default, and it is to the employer that such a company must look for information in regard thereto.

Your petitioner, therefore, avers that no harsher or stricter rule should be applied in such cases than is applied in cases of other insurance, and particularly in cases of marine and fire insurance, which are very similar to suretyship or guarantee insurance in regard to the opportunity of information concerning the risk incurred. Petitioner further avers that the rules governing life insurance should be administered even more strictly than in suretyship insurance, for the reason that controversies regarding life insurance, involving the representations made to procure it, and the covenants regarding acts to be done on the part of the person whose life is insured, ordinarily do not arise until after the death of the person whose life is insured, and his representatives are cut off from the benefit of his testimony. In the case of suretyship insurance, when a claim for a loss has been made, both parties stand on an equal footing, regarding their knowledge and ability to testify as to the representations made and the performance of the covenants put on the person holding the insurance.

In life and fire insurance, the insured is frequently ignorant and unused to dealing with a more experienced man, able to take advantage of his ignorance. It frequently happens that, in such insurance, the insured is financially weak, and carries on an unequal struggle with an opulent opponent. In surety-

ship insurance, as a rule, the contrary is true. Persons and managers of corporations seeking such insurance are usually shrewd business men, abundantly able to take care of themselves in contracting, and ordinarily careful to know the terms of a contract and scrupulous to see that they fulfill their part. In any suit that may arise with a guarantee company, they have ample resources so as to leave nothing in their favor undeveloped.

Your petitioner now shows that, under the evidence hereinbefore cited, the said circuit court of appeals, in its statement of the case, which was a part of its opinion disposing of the cause, found and ascertained the following to be the facts:

"It is in evidence that information came to the president and "directors of the bank, through their cashier, that Schardt "was a partner in what is called a 'bucket shop'—an agency "for promoting speculation in small amounts upon the fluctua- "tions of stocks, grain, cotton and other commodities in which "speculative gambling is done—and that he was himself spec- "ulating. When charged with this, Schardt admitted that he "had taken an interest in such a partnership, but that he had "sold out. He called his former partners to confirm his state- "ment in this regard. He also admitted, according to one of "the witnesses, at another time, that he had speculated to "some extent, but asserted that he had always made gains, "and had seen the error of his ways, and had stopped. Sub- "sequently, the cashier received an anonymous letter stating "that Schardt was still speculating. He informed the presi- "dent of the bank. Schardt said it was a lie, and no more "attention was paid to it. All this occurred prior to the time "when the president signed the guarantee proposal for the "cashier's bond referred to. As a matter of fact, Schardt "was speculating all the time, and lost the $100,000 he had "stolen in gambling in futures."

This honorable court in the cause of *Prather* v. *Preston*, reported in 137 U. S., 604, said in regard to the effect which

information and knowledge that an employe in a position of trust has been speculating, should have on his employer:

"In *Scott* v. *Bank*, 72 Pa. St., 479, 480, the supreme court "of Pennsylvania asserted the same doctrine as that in the "Massachusetts case, holding that a bank, as a mere deposi- "tary, without special contract or reward, was not liable for "the loss of a government bond deposited with it for safe- "keeping, and afterwards stolen by one of its clerks or tellers. "In that case it was stated that the teller was suffered to remain "in the employment of the bank after it was known that he had "dealt once or twice in stocks, but this fact was not allowed to "control the decision; on the ground that it was unknown to "the officers of the bank that the teller gambled in stocks until "after he had absconded, but at the same time observing that "'no officer in a bank, engaged in stock gambling, can be safely "trusted, and the evidence of this is found in the numerous "defaulters, whose peculations have been discovered to be "directly traceable to this species of gambling.'

"'A cashier, treasurer, or other officer having the custody of "funds thinks that he sees a desirable speculation, and takes "the funds of his institution, hoping to return them instantly, "but he fails in his venture, or success tempts him on, and he "ventures again to retrieve his loss or increase his gain, and "again and again he ventures. Thus, the first step, often "taken without a criminal intent, is the fatal step, which ends "in ruin to himself and to those whose confidence he has be- "trayed.' As stated above, the reasonable care which per- "sons should take of property intrusted to them for safekeep- "ing, without reward, will necessarily vary with its nature, "value, and situation, and the bearing of surrounding circum- "stances upon its security. The business of the bailee will "necessarily have some effect upon the nature of the care re- "quired of him—as, for example, in the case of bankers and "banking institutions having special arrangements, by vaults "and other guards, to protect property in their custody. Per- "sons, therefore, depositing valuable articles with them, expect "that such measures will be taken as will ordinarily secure the

"property from burglars outside and from thieves within, and "that, whenever ground for suspicion arises, an examination will "be made by them to see that it has not been abstracted or tam- "pered with; and also that they will employ fit men, both in "ability and integrity, for the discharge of their duties, and "remove those employed whenever found wanting in either of "these particulars.

"An omission of such measures would, in most cases, "be deemed culpable negligence, so gross as to amount to a "breach of good faith, and constitute a fraud upon the depos- "itor. It was this view of the duty of the defendants in this "case, who were engaged in business as bankers, and the "evidence of their neglect, upon being notified of the specula- "tions in stocks of their assistant cashier, who stole the bonds, "to make the necessary examination respecting the securities "deposited with them, or to remove the speculating cashier, "which led the court to its conclusion that they were guilty of "gross negligence. It was shown that, about a year before "the assistant cashier absconded, the defendant, Kean, who "was the chief officer of the banking institution, was informed "that there was some one in the bank speculating on the board "of trade in Chicago. Thereupon Kean made a quiet investi- "gation, and the facts discovered by him pointed to Ker, whom "he accused of speculating. *Ker replied that he had made a "few transactions, but was doing nothing then, and did not "propose to do anything more, and that he was then about one "thousand dollars ahead, all told.* It was not known that Ker "had any other property besides his salary. His position as "assistant cashier gave him access to the funds as well as the "securities of the bank, and he was afterwards kept in his posi- "tion without any effort being made on the part of the defend- "ants to verify the truth of his statement or whether he had at- "tempted to appropriate to his own use the property of others.

"Again, about two months before Ker absconded, one of the "defendants, residing at Detroit, received an anonymous com- "munication stating that some one connected with the bank in "Chicago was speculating on the board of trade. He there-

"upon wrote to the bank, calling attention to the reported "speculation of some of its employes, and suggesting inquiry "and a careful examination of its securities of all kinds. On "receipt of this communication Kean told Ker what he had "heard, and asked if he had again been speculating on the "board of trade. Ker replied that he had made some deals for "friends in Canada, but the transactions were ended. The de- "fendants then entered upon an examination of their books and "securities, but made no effort to ascertain whether the special "deposits had been disturbed. Upon this subject the court be- "low, in giving its decision (29 Fed. Rep., 498), after observ- "ing that the defendants knew that Ker had been engaged in "a business which was hazardous, and that his means were "scant, and after commenting upon the demoralizing effect of "speculating in stocks and grain, as seen in the numerous "peculations, embezzlements, forgeries, and thefts, plainly "traceable to that cause, and the free access by Ker to valu- "able securities, which were transferable by delivery, easily "abstracted and converted, and yet his being allowed to retain "his position without any effort to see that he had not con- "verted to his own use the property of others, or that his state- "ments were correct, held that it was gross negligence in the "defendants not to discharge him or place him in some posi- "tion of less responsibility. In this conclusion we fully con- "cur."

Your petitioner, in the argument of the cause before the said circuit court of appeals, had drawn its attention to the language of this honorable court in the cause of *Prather* v. *Preston*. Said circuit court of appeals, in its opinion, said that it agreed to all that had been said in the opinion in that cause, but, inasmuch as it did not appear that the failure to take cognizance of this speculation on the part of said Schardt, or to make report of it to your petitioner, then a surety on his bond as teller, or to communicate it to your petitioner when applying for a bond on said Schardt as cashier, was the result of bad faith on the part of any of the officers of the bank, but only bad judgment

in not being more affected by their information, held that it did not bar a recovery on the two bonds, and in regard thereto used the following language:

"But this defendant company had not contracted for such "a guaranty against negligence as had the depositors and "bailees who sustained an action of damages in those cases, "and this suggested analogy is neither a legal nor a fair test of "the contract duty of the bank to its insurer against Schardt's "dishonesty in the premises. Here, again, it must be strictly "limited to the words it has used in defining that duty, and none "is owed beyond the words by any kind of implications ener- "gized by any indignation at the negligence of the bank in "not protecting itself, or indignation at the immoral conduct "of Schardt. This insurer was insuring the bank for its pro- "tection in just such emergencies and against just such negli- "gence, unless the words of this policy speak to the contrary, "and had received the consideration for it, while the depositors "in the bank, in the cases cited, had contracted for either com- "mon prudence, ordinary vigilance, or against gross negli- "gence. It is a reversion of the attitude we have here, and it "is a perversion of that principle to apply it here."

Then, proceeding to construe said bond as teller, which had expressly stipulated that "the employer shall at once notify "the company on its becoming aware of said employe being "engaged in speculation or gambling, or indulging in any dis- "reputable habits or pursuits," the said circuit court of appeals held that inasmuch as when said Schardt had admitted his part ownership in a "bucket shop," and that he had been speculating, he claimed he had sold his interest in the "bucket shop" and had ceased to speculate, the bank was not bound to give notice of the fact so coming to its knowledge, because it was a "past event," and it would be held to the duty of giving notice of such speculation, gambling, disreputable or unlawful habits or pursuits only when he was engaged therein at the very instant and time of discovery. Your petitioner submits that by a fair construction of the

words used in the stipulation for its protection said bank was bound to report its knowledge so obtained, even though said Schardt claimed that he had sold out his interest in the bucket shop and had ceased to speculate. Said circuit court of appeals further held that being a partner or stockholder in a bucket shop was not speculation or gambling, or engaged in it, *but only being the agent of those who were speculating and gambling.* The court so held, notwithstanding it is a fact so widely and generally known that all courts will take judicial notice thereof, that a brokerage business is one of agency where the broker takes the order of the person speculating and has it executed through a member of some one of the stock, grain, or cotton exchanges, the member of such exchange with whom he deals securing either the profit or making good the loss to the broker's customer, while the broker, for compensation to himself, receives a small commission on the sale. In a "bucket shop," however, the orders are not executed on any exchange, but the bucket shop settles with persons dealing with it according to the rise or fall of the thing dealt in. It is the proprietors of the bucket shops who become the principals in the wager with the customer.

The said circuit court of appeals furthermore held that, should the bank become aware of any disreputable habit or pursuit, and it was claimed the habit or pursuit had been abandoned, it was not bound to give notice thereof to the company.

In the application for the cashier's bond, as hereinbefore set out, the president of the Mechanics' Savings Bank & Trust Company was asked, "Have you known or heard anything unfavor-"able as to his (the said Schardt's) habits or association, past "or present? Or of any matter concerning him about which "you deem it advisable for the company to make inquiry?" To both of said questions, said president had answered "No." Said circuit court of appeals held, under the evidence hereinbefore cited, it did not appear that said Baxter in bad faith withheld the information possessed by him; and, if in good faith, he did not believe what he heard to be unfavorable, because Schardt had ceased to speculate and had sold his

interest in the bucket shop, or in like good faith did not deem it advisable that the insuring company should make inquiry, his answer was true, but he was made the judge of what was unfavorable or what was advisable. The circuit court of appeals furthermore said that it doubted if dealing in futures or speculation would be considered as embraced in the question asked, and that, for an employe to be given to dealing in futures and to be speculating, would not be considered an unfavorable habit or association. The court held finally, and repeated, that the quality of being unfavorable or advisable was left open to construction by the mind of him who was answering the question, and assumed that the mind of said Baxter had so construed it. It appears from the transcript that said Baxter is living, and could have been called as a witness on behalf of the said assignee, but, for some reason, he was not called by him, nor was any explanation given of his failure to do so.

Your petitioner now shows to this honorable court that the opinion of said circuit court of appeals is in irreconcilable conflict with the holding of this court in the case of *Prather* v. *Preston*. The public interest demands that the authority of *Prather* v. *Preston* shall in nowise be diminished or impaired, and the effect of the holding of the said circuit court of appeals in the present case is to say that the superiors of employes in positions of trust, who are found to be speculating, are not, in all cases, bound to institute an immediate examination of their accounts, and to dismiss them from the position where they have an opportunity to wrongfully possess themselves of money for the continuing of their speculations, but that they can, at least so far as guarantee companies are concerned, continue them in their positions, without an examination of their books, hold them out as worthy of confidence, and secure guarantee insurance to whatever amount they may desire, and so place on such companies the losses which come from the defaults they will in all likelihood commit.

Petitioner further shows that during the whole of the time it was the surety of said John Schardt to said Mechanics' Savings

Bank & Trust Company, there were kept in the bank the accounts of the bank with its individual depositors in two large books. These books were kept by one Frank Boensch, known as individual bookkeeper. With the keeping of these books said Schardt had nothing to do. There were, in addition, three general books, all kept by said Schardt: (1) A general ledger, showing generally the accounts of the bank, including the total deposits, but not in detail the accounts of the depositors. It purported to show the total deposits paid in and those checked out each day, and purported to show each day the aggregate amount due to depositors. It showed a statement of the demand loans, discounts, bonds, stocks, etc., owned by the bank. (2) A cash-book, showing day by day the entire business transacted on any particular day. For each day the account would begin with the cash on hand at the opening of the bank on that day, and would be debited with all the receipts for the day, showing from what source derived, and would be credited with all disbursements, showing on what account made. (3) A daily balance book, showing a summary of each account in the general ledger, and showing at the end of each day's business all the assets and liabilities of the bank under appropriate headings. Thus, it showed the amount of cash, notes, stock, bonds, etc., owned by the bank, and the amount the bank owed depositors, other banks, bills payable, etc.

It was found by said circuit court of appeals, and stated in its opinion:

"While Schardt was teller, he kept the general ledger "and the cash-book, and made the daily statement of the "bank. A clerk kept the individual ledger. The individ-"ual ledger was correctly kept. Whenever Schardt abstracted "money from the deposits, he would place the items correctly "in the cash-book, but he would make false totals, less by "the amount he had taken than the true totals, and these false "totals he would transfer to the individual deposit accounts on "the general ledger. Until 1890 it had been the practice in "the bank every month to take trial balances of the individual

"ledger accounts, and verify the balances thus shown with those "of the general ledger. Schardt directed the clerk to discon- "tinue this, and thereafter, from 1890 until the collapse of the "bank, no balance was ever taken from the individual ledger, "and no comparison was ever made between Schardt's balances "as shown by the general ledger and those which could have "been shown by the individual ledger. These two ledgers were "out of balance $2,098 January 16, 1891; $19,600 January "1, 1892, and $69,700 January 1, 1893. The discrepancies "were caused by Schardt's embezzlement of the deposits. In "addition to this amount, Schardt embezzled $3,765.44 in the "year between January, 1891, and January 1892, and $4,- "015.44 in the year between January 1, 1892, and January 1, "1893, of money received by him from the proceeds of notes "due the bank and in his custody for collection. The finance "committee of the board of directors of the bank made quar- "terly examinations of the bank. These examinations consisted "of checking over a statement made by Schardt of the condi- "tion of the bank, with the notes and securities and cash "which he produced, and with statements from other banks of "credit balances. There is some doubt as to whether the "finance committee saw the cash-book or what purported to "be a copy of a statement taken from it."

The undisputed and uncontradicted evidence, both of the witnesses for petitioner and of the witnesses on behalf of the assignee, showed that it was customary in all banks, whether large or small, to compare, at least once a month, the amount shown to be due to individual depositors by the ledger of individual deposits with the amounts shown to be due depositors by the general ledger and the daily balance book. The said circuit court of appeals made no finding in regard to the conclusion established by said evidence, but said in regard thereto:

"Much proof was taken to show what kind of supervision "is ordinarily and prudently taken by other banks, and gener- "ally in the banking business, to prevent default, it being as-

"sumed that there was a contract here for that kind of super-
"vision, or, at least, that which ordinary prudence in any
"business would require. Certainly these words (due and cus-
"tomary supervision over the said employe for the prevention
"of default, and all due and customary diligence in the super-
"vision of said employe for the prevention of default), may
"mean that, but not necessarily. They may mean less; for
"example, they may mean that 'due and customary super-
"vision' which obtained in this particular bank, not over all
"employes, but over the teller; not over all of its business in
"every direction, but only that over which he did. It may
"mean that which was in vogue when the contract was made,
"or that subsequently coming into use as affording a better
"mode of detection. If that supervision which it was cus-
"tomary for the authorities of this bank to keep over the
"teller was careless and ineffective for detection, it would be
"none the less 'due and customary,' and that which they took
"'to prevent default.' . . The words of either of the bonds we
"have quoted are ambiguous, and may embrace any degree or acts
"of supervision, from the highest and most certainly effective
"to those which are least so, so long as they are 'customary' or
"'due.' The standard of excellence or efficiency is not definitely
"mentioned, nor is any rule of custom definitely prescribed,
"whether of this bank or of all banks, or of any business in which
"cashiers and tellers are employed. By the rule we have laid
"down, the defendant company should have been more specific
"in defining the supervision they required; and the contract
"should have added, if that was the intention, all due and cus-
"tomary supervision in use in the best-managed banks, or gen-
"erally in use by banks conducted with ordinary prudence and
"skill, or some words sufficiently designating the general cus-
"tom now sought to be relied on, if there were at that time
"any such general custom prevailing in the management of
"banks, not words applicable to any prudent supervision in
"many different ways, but those pointing out a custom of su-
"pervision in the particular way now insisted upon."

Said circuit court of appeals, in its opinion, under authority of two cases adjudged by this court (*Goddard* v. *Foster*, 17 Wall., 123, and *Insurance Co.* v. *Wright*, 1 Wall., 456), held that parol evidence of usage or custom was not admissible to control, vary, or contradict an express contract; but, inasmuch as when the Mechanics' Savings Bank & Trust Company, when applying for a bond on John Schardt as teller, was asked, in its application, by your petitioner, "What is your "*custom* in regard to the frequency of inspections? Are "they at stated intervals or irregular, and what is the longest "time allowed to elapse between inspections?" and answered, "Every quarter," it was the duty of the court, in accordance with familiar general rules of technical interpretation, to read these words, "due and customary," in the light of that question and answer, and to hold that such quarterly inspection was the due and *customary* supervision referred to in these bonds and provided for by the contract; and your petitioner having thus expressly contracted as to the "custom," could not be permitted to show what in all other banks was considered as due and customary supervision for the prevention of default.

In disposing of the further defense interposed by petitioner, that the renewal of the teller's bond for the year 1892 was procured by the false statement contained in the certificate of the bank that the accounts of said Schardt, up to the first of January, 1892, had been examined and verified, when, in fact, they had been neither examined nor verified, and such examination or verification would have at once disclosed the existence of the default, said circuit court of appeals held as follows:

"However careless the examination may have been, if made "in good faith, and the examiners believed the accounts cor-"rect, they might truthfully so represent them, albeit they "were not correct. The position of the defendant company "leaves no margin here, and holds the bank to absolute truth-"fulness, not of the fact of examination made in good faith, "and a belief in correctness, but of the soundness of Schardt's "entries and accounts and their freedom from fraud—no mat-

"ter how skillfully a fraud may have been concealed by him. "The facts do not show any such intentional representation, "and the words do not define such a complete assurance. The "words 'correct' and 'verified' may mean that, but also less "in any degree. One 'verifies' an account by merely adding up, "or doing the other work of mathematical calculation, and find- "ing the figures correct, or by such comparison of entries and "items as one may make and find correct, and any extent of "this is examination, however superficial. These representa- "tions do not say that the examination was skillful or exten- "sive, or by comparison of books and trial balances, but only "that such examination as was made disclosed no error or fraud; "and if this was done in good faith, as there is no doubt it was, "it fully meets the representations made, unless we are to imply "that the parties intended such a thorough examination as "would save the insurer harmless, and this, we think, was not "contracted for in plain and unambiguous language, as it might "have been if intended."

Petitioner shows that the substance of the holding of said circuit court of appeals was that a surety company, in the absence of stipulations in respect thereof, was not entitled to have any degree of supervision kept over the employe for the prevention of default; and if a stipulation should be made regarding such supervision, the words used were not to be taken in their plain and ordinary sense and acceptance, but were to be construed against the surety company with the utmost harshness, and if an examination, however loose, could by a construction, however strained, be made to satisfy the letter of the bond, it should be deemed sufficient. The reason stated by the court is that such bonds of indemnity are sought for the purpose of enabling bank officials to be able to relax their vigilance, and to feel secure because they hold such indemnity.

Your petitioner shows that such a view wholly mistakes the scope and purpose of such insurance. No vigilance, however great, no supervision, however strict, can entirely eliminate the possibility of peculation on the part of the employe. There

comes an interval between all examinations when an embezzlement cannot by any possibility be prevented. With every examination, however strict and thorough, there is a manipulation possible by which a default can for a time be covered up. Such bonds are sought not for the purpose of rendering examinations useless, and not for the purpose of being able to relax the supervision over the employe, but for the purpose of covering this element of chance of an embezzlement which no foresight and no care can guard against. Such insurance is never sought for an amount equal to the sum to come into the hands of the employe, or the amount of a possible embezzlement. In the present case, notwithstanding Schardt had the opportunity to, and as teller did, embezzle exceeding $70,000, yet the penalty of the bond was for only $10,000. In the present case it cannot be said that the bond was procured for the purpose of enabling the bank officials to relax the vigilance of their supervision over its teller, for the reason that the amount of his possible embezzlement was many fold the penalty of the bond, and the amount of his actual embezzlement was sevenfold its penalty.

Your petitioner shows that it would be contrary to public policy, and greatly detrimental to the public interest, for the rule to be established that the officials of corporations can dispense with all care in overlooking employes under them if they hold a bond for a fraction of the amount which they might embezzle.

Your petitioner shows that the present judgment of the circuit court of appeals has excused a negligence that has gone to the extremest possible limit. For three years the ledgers of the bank were out of balance, for a long time in an amount exceeding the capital stock of the bank, and a comparison of these, such as is customary in all other banks every thirty days, and was customary in this bank until just before the default commenced, would have in an instant disclosed the existence of such shortage and its approximate amount. For three years the notes in the hands of the teller and cashier did not correspond with the notes a list of which was found in the general books, and

a comparison of them at any time within the last three years of Schardt's connection with the bank would have disclosed such shortage and its amount. Such a comparison is the first principle of every examination.

In fact, said circuit court of appeals, in its opinion as first prepared and printed, said:

"We concede that it is difficult to see how the officials of "this bank could have failed, by ordinary prudence, to have "discovered these frauds, or how, without some negligence, "the losses could have occurred. But it does not follow from "this that this company, which has guaranteed to the bank and "its stockholders the fidelity of the teller and cashier, can "escape its liability because of such negligence."

When the opinion was filed with the clerk of the circuit court of appeals, on April 29, 1897, as may be seen from page 13 of the opinion, as found in the transcript accompanying this petition, the sentence just quoted was changed to read as follows:

"If we were to concede that the officials of this bank could "not have failed, by ordinary prudence, to have discovered "these frauds, or that without some negligence the losses could "have occurred, it would not follow from this that this com-"pany, which has guaranteed to the bank and its stockholders "the fidelity of the teller and cashier, can escape its liability "because of such negligence."

This honorable court, in *Briggs* v. *Spaulding*, 141 U. S., 132, said:

"We hold that directors must exercise ordinary care and "prudence in the administration of the affairs of a bank, and "that this includes something more than officiating as figure-"heads. They are entitled under the law, to commit the bank-"ing business, as defined, to their duly authorized officers, "but this does not absolve them from the duty of reasonable "supervision."

Not only was the bank bound to exercise such a reasonable supervision, through its board of directors and its finance committee, but it was bound to exercise a stricter and more rigid supervision through its president and cashier, salaried officers constantly at the bank, and the superiors of said Schardt so long as he was teller.

Petitioner is advised that as a matter of law such duty of reasonable supervision was imposed on the officers and directors of the Mechanics' Savings Bank & Trust Company, and that duty was in favor of every person who would be injured by its neglect, including the surety on the bond of its officers handling its cash and funds. Petitioner is further advised that particularly was this duty owed to it, as it was expressly stipulated for in the bonds, and the holding of the said circuit court of appeals is in irreconcilable conflict with the holding of this honorable court in *Briggs* v. *Spaulding*.

Finally, petitioner shows that whatever may be the rule of construction of the provisions of the bonds regarding supervision, and however forced the meaning given to the words, there is no possible construction which does not involve a violation of its duty and agreement on the part of the Mechanics' Savings Bank & Trust Company. Whether the words mean the kind of supervision that is ordinarily and prudently taken by other banks, or generally in the banking business, or that which obtained in this particular bank, either over all its employes or over the teller, or over its business in every direction, or over that which the teller did, or that in vogue when the contract was made, or that subsequently coming into use, in each and every case which the ingenuity of the judge delivering the opinion was able to suggest, there was not, on the part of the bank, that supervision it agreed to exercise.

Your petitioner further shows that the said circuit court of appeals, in its opinion and judgment, disregarded the provision of the teller's bond, which provided that it should cover only losses sustained and "discovered during the continuance of the "currency of this bond, and within six months from the em- "ployе's ceasing to be in said service." No loss was discov-

ered during the continuance of the currency of said bond, but was not discovered until April following the January when the bond had expired by its own limitation.

Wherefore your petitioner respectfully prays that a writ of *certiorari* may be issued out of and under the seal of this court, directed to the United States circuit court of appeals for the sixth circuit, commanding said court to certify and send to this court, on a day certain, to be therein designated, a full and complete transcript of the record and all the proceedings of the said circuit court of appeals in the said case therein, entitled "*The "Guarantee Company of North America, Appellant,* v. *The "Mechanics' Savings Bank & Trust Company, for the use of J. "J. Pryor, Assignee, etc., Appellee,*" number 349, to the end that said case may be reviewed and determined by the court, as provided in the sixth section of the act of Congress, entitled: "An act to establish circuit courts of appeal, and to define and "regulate in certain cases the jurisdiction of the courts of the "United States, and for other purposes," approved March 3, 1891, or that your petitioner may have such other or further relief in the premises as to this court may seem appropriate, and in conformity with said act, and that the said decree of the said circuit court of appeals in the said case, and every part thereof, may be reversed by this honorable court.

And your petitioner will ever pray, etc.

GUARANTEE COMPANY OF NORTH AMERICA,

By Wm. L. Frazer,

Albert D. Hedges,

Solicitors and Counsel for Petitioner.

STATE OF TENNESSEE, } ss.
Davidson County. }

Theo. Cooley, being duly sworn, says that he is the general agent for the southern department of the Guarantee Company of North America, the petitioner above named, and, as such, has had personal charge for it of the case mentioned in the foregoing petition in the circuit court of the United States for the middle district of Tennessee, and in the United States circuit court of appeals for the sixth circuit; that he has read the foregoing petition, and the facts therein stated are true to the best of his information and belief.

Sworn to and subscribed before me December 23, 1897.

Notary Public.

UNITED STATES OF AMERICA—ss.

TO JAMES J. PRYOR, *Assignee of the Mechanics' Savings Bank & Trust Company—Greeting:*

You are hereby cited and admonished to be at a Supreme Court of the United States to be holden at Washington, on the second Monday in January, 1898, pursuant to a petition filed in the clerk's office of the United States Supreme Court, wherein the Guarantee Company of North America is petitioner, and James J. Pryor, as assignee of the Mechanics' Savings Bank & Trust Company, is respondent, to show cause, if any there be, why the prayer of such petition shall not be granted, and an order made by the supreme court of the United States for a writ of certiorari requiring the circuit court of appeals for the sixth circuit to certify to the supreme court, for its review and determination, the said case of the *Guarantee Company of North America, appellant*, v. *James J. Pryor, assignee of the*

Mechanics' Savings Bank & Trust Company, appellee, and speedy justice should not be done to the parties in that behalf.

Witness, the Honorable Melville W. Fuller, chief justice of the United States, this the twenty-third day of December, in the year of our Lord, 1897.

Circuit Judge.

Service of the foregoing citation is acknowledged for and on behalf of James J. Pryor, assignee of the Mechanics' Savings Bank & Trust Company.

This the twenty-third day of December, 1897.

Solicitor and Counsel for James J. Pryor, Assignee, etc.